INITIAL COMMENTS ON
FAIR AND EQUITABLE TOBACCO REFORM ACT OF 2004

Submitted to the United States Department of Agriculture
by Liggett Group Inc.
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INTRODUCTION

In implementing the Fair and Equitable Tobacco Reform Act of 2004 (the "Act"), the United States Department of Agriculture ("USDA") must take into account the dramatic changes that have occurred in the last few years in the U.S. tobacco industry. Seven years ago, a handful of companies made up the domestic tobacco industry. Today, some 150 new manufacturers and importers have entered the business, and the marketplace for tobacco products is highly volatile.

An important consequence of the tobacco industry's state of flux is that manufacturer and importer market shares can change significantly over relatively short periods of time. The method for calculating assessments under the Act must recognize these rapid changes by basing assessments on current market shares, not historical market shares. In addition, new manufacturers and importers are often entering the market, and these companies do not have historical market shares. Any method for calculating assessments that uses historical market share data will unfairly exempt new entrants from assessments for some period of time. Finally, if the industry's experience with the Master Settlement Agreement and the related state escrow statutes is any indication, many of the new manufacturers and importers that enter the U.S. market will be exceedingly creative and agile in evading and avoiding their statutory and regulatory obligations. USDA will need to be vigilant in its enforcement efforts.

SPECIFIC COMMENTS

1. <u>Market Share for a Quarter Should Be Used to Calculate the Assessment for that Quarter</u>

Assessments for each quarter should be based on the actual market share for that same quarter. Thus, market share should be calculated on a quarter-by-quarter basis. The market share for each quarter should then be used to determine the assessment for that quarter, and the assessment should be paid at the end of the next quarter.

Using a market share from an earlier period is inaccurate, unfair, and open to potential abuse. For example, where the assessment lags from market share, if a manufacturer's market share has declined since the earlier period, then the manufacturer is penalized by having to pay more of an assessment than its current market share warrants. On the other hand, if a manufacturer's market share has increased since the earlier period, that manufacturer receives a windfall and is not paying its fair share.

2. Prevent a Loophole for New Market Entrants

If market share is calculated based on a prior period, then a potentially huge loophole exists for new entrants into the market. A new entrant will not have any market share for the earlier period, since it did not exist. Thus, if market share were calculated based on the 12 months ending June 30 before the fiscal year begins, then a new manufacturer or importer would have up to 15 months (July 1 of one year through September 30 of the next) during which it could operate and sell tobacco products without paying any assessments. It could then "disappear" before having to pay, by changing its corporate structure or otherwise. It might thereafter be able to reappear, undetected, as a different corporation and begin the process again.

3. Make Clear the Date that the First Assessment Period Begins

The Act seems clear that the first assessment period begins October 1, 2004. There has been some confusion in the marketplace. The confusion may derive from a misunderstanding of when federal fiscal year 2005 began. The Act clearly states that USDA "shall impose quarterly assessments during each of fiscal years 2005 through 2014" and that the assessments shall begin "with the calendar quarter ending on December 31 of each of fiscal years 2005 through 2014." Section 625(b)(1) and (2). Regardless of when the first assessments are to be collected, to avoid confusion in the marketplace, USDA should formally announce the starting date for the first assessment period. Furthermore, if collection of the first assessments lags by a period of months from the end of the first assessment quarter, USDA should take steps to avoid the potential that a market participant with little investment in the United States could exit the marketplace without remitting assessments it owes.

4. Clarify the Definition of Gross Domestic Volume

The definition of gross domestic volume should be clarified to exclude returned goods, so as to most accurately reflect market share. Otherwise, a manufacturer or importer with a percentage of returned goods that is higher than the industry average is unfairly penalized and one with a returned goods percentage below the industry average – or one that does not accept returns – is unfairly rewarded. A domestic volume that is net of returned goods (along the lines of how federal excise taxes are calculated) is more accurate and fair reflection of the true size of the market.

5. Unclear Language

Explain the meaning of Section 625(d)(3)(B). This language appears to indicate that assessments must be made quarterly, based on the market share in the prior quarter, as noted in comment 1 above.